

BACKGROUND PAPER

INFORMATIONAL HEARING ON

SALES TAXATION OF JET FUEL

Tuesday, September 28, 2004
11:00 a.m. - 1:00 p.m.
San Diego County Administration Building
1600 Pacific Highway - Room 358
San Diego, California

INTRODUCTION TO THE HEARING

In August 2004, the Assembly Revenue and Taxation Committee was asked to consider AB 2466 (Yee), a measure that would modify the rules for allocating local Bradley-Burns sales and use tax revenue generated from sales of jet fuel. During meetings convened to bring interested parties together and during hearings on the measure, it became clear to Chairman Bermudez that the issue of jet fuel taxation warranted further study.

In a series of regional informational hearings, the Assembly Revenue and Taxation Committee plans to examine jet fuel sales taxation from a number of different angles. We will begin by focusing on state sales tax policies involving jet fuel, by soliciting input on this topic from the Board of Equalization, Legislative Analyst's Office, airline industry tax managers, and local government representatives. During a subsequent hearing, we plan to address local sales tax allocation procedures. By soliciting speakers who represent all of the major players in this debate – including the state, local governments, and the airline industry – we will attempt to explore how well existing state and local tax policy relating to jet fuel is working and discuss various options for change and improvement.

The background information that follows in the remainder of this paper is intended to set the context for testimony that will be offered during the September 28, 2004 hearing on state sales tax treatment of jet fuel.

STATE AND LOCAL SALES AND USE TAX RATES

Existing law imposes a sales tax on retailers for the privilege of selling tangible personal property at retail. California also imposes use tax on persons who purchase tangible personal property outside California for storage, use, or consumption within the state. As of September 1, 2004, the sales and use tax rate imposed statewide includes the following components:

- 1) A 5.25% General Fund rate*, of which 0.25% is dedicated toward repaying the economic recovery bonds approved by voters in March 2004 through passage of Proposition 57.
- 2) A 0.5% Local Revenue Fund rate, dedicated to specific health and social services programs shifted from the state to local governments in 1991.
- 3) A 0.5% Local Public Safety Fund rate, dedicated to local public safety services.
- 4) A 1.0% Bradley Burns rate*. This Bradley-Burns rate includes a 0.25% rate dedicated to use by counties for transportation purposes and a 0.75% rate that can be used by cities for general purposes.
- 5) Certain local jurisdictions have also adopted transactions and use taxes at rates ranging from 0.125% to 0.5%.

*The state sales and use tax rate will return to 5%, and the Bradley-Burns rate will return to 1.25%, when the economic recovery bonds are paid off.

STATE AND LOCAL SALES TAXATION OF JET FUEL

The state's current rules for taxing jet fuel and allocating jet fuel revenue have evolved over the past fifteen years.

Pre-1991

Prior to July 15, 1991, fuel and petroleum products sold to air, water, and rail common carriers and used in the conduct of the carriers' commercial activities after the first out-of-state destination was exempt from sales tax. For example, under the pre-1991 rules, air, water, and rail common carrier fuel used to propel planes, ships, and trains to an international destination was exempt from sales tax. Air, water, and rail common carrier fuel used to propel planes, ships, and trains beyond their first out-of-state destination was also exempt. The only air, water, and rail common carrier fuel that was taxed was that which was required to propel the plane, ship, or train to its first out-of-state destination.

These exemptions were intended to make California's ports, airports, and rails more competitive with ports, airports, and rails in other states and countries. The exemptions

were also intended to ensure consistency in the Sales and Use Tax Law with respect to interstate and foreign commerce.

1991 To The Present

The common carrier fuel exemptions were repealed by AB 2181 (Vasconcellos), Chapters 85, Statutes of 1991 and SB 179 (Deddeh), Chapter 88, Statutes of 1991, as part of the agreement to help address the significant budget shortfall that the state was experiencing at that time.

Under the changes, all fuel and petroleum products sold to common carriers and used to propel planes, ships, and trains to destinations inside the United States became taxable. The table below indicates the ways in which the taxation of fuel and petroleum products changed upon enactment of AB 2181 and SB 179.

FLIGHT PLAN	SALES TAX TREATMENT PRE-1991	CURRENT SALES TAX TREATMENT
San Francisco-New York	Taxable (NY is first out-of-state destination)	Taxable
San Francisco-Los Angeles-New York	Taxable (NY is first out-of-state destination)	Taxable
San Francisco-Denver-New York	SF-Denver Taxable, Denver-NY Exempt (Denver is first out-of-state destination)	Taxable
San Francisco-Honolulu-Sydney	Exempt (international flight)	Exempt (international flight)
San Francisco-Sydney	Exempt (international flight)	Exempt (international flight)

The changes made in 1991 to sales taxation of air and rail common carrier fuel have remained in place since that time. Numerous attempts to reinstate the exemptions in place prior to 1991 failed, mostly for fiscal reasons [e.g. - AB 2396 (Elder), 1992; AB 3375 (Olberg), 1996; AB 566 (Kaloogian), 1996; AB 1800 (Machado), 1998; and AB 2470 (Wiggins), 1998]. The fiscal impact of reinstating the exemption for air common carriers is a moving number that is directly related to the highly volatile price of jet fuel. Estimates made for the 1998 bills referenced immediately above equaled approximately \$35 million annually.

The water common carrier fuel exemption was reinstated in 1992 over concern that taxation of water common carrier fuel had resulted in significant declines in the number of ships that chose to fuel in California and in a resulting decline in employment at California ports. The water common carrier fuel exemption has remained in place with only one short hiatus since 1992. It is currently scheduled to sunset on January 1, 2014 [SB 808 (Karnette), Chapter 712, Statutes of 2003].